COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
CASE NOS. 2015-SC-178-DG and 2015-SC-181-DG

LORI HUDSON FLANERY (in her official capacity as Secretary of the Finance and Administration Cabinet, Commonwealth of Kentucky);

THOMAS B. MILLER (in his official capacity as Commissioner of the Department of Revenue, Finance and Administration Cabinet, Commonwealth of Kentucky); and

KENTUCKY CATV ASSOCIATION, INC. APPELLANTS

vs.

ON REVIEW FROM COURT OF APPEALS
NO. 2013-CA-001112
FRANKLIN CIRCUIT COURT NO. 11-CI-01418

CITY OF FLORENCE, KENTUCKY; CITY OF WINCHESTER, KENTUCKY; CITY OF GREENSBURG, KENTUCKY; CITY OF MAYFIELD, KENTUCKY; KENTUCKY LEAGUE OF CITIES, INC.

APPELLEES

THE FINANCE AND ADMINISTRATION CABINET'S BRIEF

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing was served upon Barbara B. Edelman, David J. Treacy, Haley Trogdlen McCauley, Dinsmore and Sholh LLP, 250 W. Main St., Suite. 1400, Lexington, KY 40507; Timothy J. Eifler, Douglas F. Brent, and Jackson W. White, Stoll Keenon Ogden PLLC, 500 W. Jefferson St., Suite 2000, Louisville, KY 40202; Eric S. Tresh, Maria M. Todorova, Sutherland Asbill & Brennan, 999 Peachtree Street NE, Suite 2300, Atlanta, GA 30309-3996; Phillip Shepherd, Chief Circuit Judge, Div. I, Franklin Co. Courthouse, 222 St. Clair St., Frankfort, KY 40601; and Sam Givens, Clerk of the Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601 by first class mail this the 11th day of April, 2016. I further certify the record was not withdrawn.

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INTRODUCTION

This case concerns the constitutionality of the Multichannel Video Programming and Communications Services Tax (the "Telecommunications Tax") administered by the Finance and Administration Cabinet's Department of Revenue. The cities involved (here, the Appellees), seek a declaration that the Telecommunications Tax violates Kentucky Constitution Sections 163 and 164 insofar as the statutory framework requires that in order to receive a portion of the revenue generated from the tax distributed monthly to local jurisdictions by the Department of Revenue, political subdivisions must refrain from levying and collecting franchise fees from public utilities using their rights-of way.

STATEMENT CONCERNING ORAL ARGUMENT

The Appellant, the Department of Revenue, requests oral argument to allow the parties a full opportunity to clarify for the Court any questions it may have concerning the issues on appeal.

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STATEMENT OF THE CASE

This case concerns the constitutionality of the Multichannel Video Programming and Communications Services Tax (the "Telecommunications Tax") administered by the Finance and Administration Cabinet's Department of Revenue (the "Department"). The material facts are undisputed.

The Appellees contend that the Telecommunications Tax described below violates Kentucky Constitution §§ 163 and 164 insofar as the statutory framework requires political subdivisions to refrain from levying or collecting franchise fees from public utilities using their rights-of-way in order that they may receive a portion of the revenue generated from the tax, which is distributed monthly by the Department, as explained in more detail in Part B below. (R. 14) The circuit court upheld the statutory provisions at issue as constitutional; on appeal, the Court of Appeals disagreed, as explained in more detail in Part C below. Copies of these opinions may be found at Appendices B and A, respectively.

Our position is that "[t]here is no constitutional prohibition that limits the General Assembly's significant power over the franchising of public utilities within a municipality, including an inherent right and power to exercise control of the levy and collection of franchise fees." (Appellee's Br. 11)[1](R. 295) We begin our statement of the case by describing Kentucky Constitution §§ 163 and 164.

A. Kentucky Constitution Sections 163 and 164.

In 1891, the "new" Kentucky Constitution was ratified, bringing new provisions, including "provisions pertaining to municipalities" that are the subject

[1] This reference is to the Department's Brief before the Court of Appeals.

of this case. See Stone v. Pryor, 103 Ky. 645, 45 S.W. 1053, 1053 (1898). Section 163 prohibits the indiscriminate use of a city's rights-of-way by public utilities without the city's consent as to what streets or other public ways are to be occupied by those utilities:

> No street, railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or erect poles, posts or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply.

Section 164 requires the advertisement and a bidding process before such a privilege or "franchise" may be granted for the use of public rights-of-way, and prohibits a term exceeding twenty years:

> No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such a franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any and all bids. This section shall not apply to a trunk railway.

Copies of Ky. Const. §§163 and 164 may be found at Appendix C. These constitutional provisions apply to all utilities and other businesses of a public nature possessing attributes of a public utility using rights-of-way, and envision the collection of tolls or charges sometimes called "franchise fees" as remuneration to the local authority for the use of the rights of way. See City of Owensboro v. Top Vision Cable Co. of Ky., 487 S.W.2d 283, 287 (Ky. 1972).

B. Related Kentucky Statutes.

1. Kentucky Revised Statutes Chapter 96.

Shortly after the Kentucky Constitution was ratified, the Kentucky General Assembly enacted laws to effectuate these two constitutional provisions. See generally, Ky. Rev. Stat. §§96.010 through 96.045. The General Assembly has mandated that cities shall provide for the sale of a new franchise at least eighteen months before the expiration of an existing franchise performing the same service on terms "that are fair and reasonable to the city, to the purchaser of the franchise, and to the patrons of the utility." Ky. Rev. Stat. §96.010. A deposit must accompany a bid for the franchise offered for sale when the offeror is not the current franchisee. See Ky. Rev. Stat. §96.020. Consolidated local governments and cities of the first class are prohibited from granting an "exclusive privilege" through the sale of a franchise. Ky. Rev. Stat. §96.030. Cities are allowed to furnish their own utilities. See Ky. Rev. Stat. §§96.040; 96.160; 96.170; 96.190; 96.210. A multitude of other statutes enacted over time contained in Ky. Rev. Stat. Chapter 96 prescribe how cities must operate city-owned utilities and authorize cities to issue bonds to construct or pay for city-owned utilities, as well as how cities may regulate and control privately-owned utilities. See generally, Ky. Rev. Stat. §§ 96.050 through 96.943.

2. Kentucky Revised Statutes Chapter 278.

In 1934, the General Assembly exercised some control over political subdivisions' franchise agreements by establishing the Public Service Commission in which it lodged exclusive jurisdiction "over the rates and service

of utilities." Ky. Rev. Stat. §278.040(2). "Rate" means the "charge, rental or the compensation for service rendered or to be rendered by any utility[.]" KRS 278.010(12). "Service" refers to "the quantity and quality of the commodity furnished as contracted for[.]" People's Gas Co. of Ky. v. City of Barbourville, 291 Ky. 805, 165 S.W.2d 567, 571 (1942); see also, KRS §278.010(13). Over time the General Assembly enacted other provisions relating to the regulation of public utilities, which presently are found in Ky. Rev. Stat. Chapter 278.

3. The Telecommunications Tax.

In 2005, as part of its tax modernization effort, the Kentucky General Assembly enacted the Telecommunications Tax, codified at Ky. Rev. Stat. §§136.600 *et seq.*, which is to apply state-wide and be administered by the Department. See , 2005 Ky. Acts, ch. 168 §§88-118 (eff. Jan. 1, 2006).

The Telecommunications Tax imposes a 3% excise tax on the retail purchase of multichannel video programming service[2] ("MVP service"), as well as a 2.4% tax on the gross revenues received by all providers of MVP service, and 1.3% tax on the gross revenues received by providers of communications services.[3] Ky. Rev. Stat. §§136.604(1),(2); 136.616(1),(2). Together these provisions effectively impose a 5.4% tax on total charges for MVP service and a 4.3% tax on total charges for telecommunications services.

The General Assembly's purposes for the enactment of the tax and

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[2]"Multichannel video programming service" means programming provided by or generally considered comparable to programming provided by a television broadcast station . . ." and includes "cable service, satellite broadcast and wireless cable service, and internet protocol television[.]" Ky. Rev. Stat. §136.602(8).

[3]"Communications service" is "the provision, transmission, conveyance, or routing, for consideration of voice, data, video, or any other information signals . . ." and includes telephone service. Ky. Rev. Stat. §136.602(2).

distribution system were to:

> (1) [a]ddress[] an important state interest in providing a fair, efficient, and uniform method of taxing communications services sold in this Commonwealth;
> (2) [o]vercome[] limitations placed upon the taxation of communications service by federal legislation that has resulted in inequities and unfairness among providers and consumers of similar services in the Commonwealth[4];
> (3) [s]implif[y] an existing system that include[ed] a myriad of levies, fees, and rates imposed at all levels of government making it easier for communications providers to understand and comply with the provisions of the law;
> (4) [p]rovide[] enough flexibility to address future changes brought about by industry deregulation, convergence of service offerings, and continued technological advances in communications; and
> (5) [e]nhance[] administrative efficiency for communications service providers, the state, and local governments by drastically reducing the number of returns that must be filed and processed on an annual basis.

Ky. Rev. Stat. §136.600. The Telecommunications Tax became effective January 1, 2006.

Under the 2005 legislation, local franchise taxes or fees exacted by municipalities for the utilization of public rights-of-way were replaced by the Telecommunications Tax. As we explain just below, a portion of the revenue collected is distributed to the local jurisdictions monthly. The law also removed providers of cable and other communications services from the list of public service corporations subject to an ad valorem tax on their intangible "franchise." See generally, 2005 Ky. Acts, ch. 168, §120 (amending Ky. Rev. Stat. 136.120).[5]

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[4]Pursuant to §602 of the federal Telecommunications Act of 1996, the satellite companies are exempt from all local taxes and fees. See Pub. L. No. 104-104, Title VI, §602(a), 110 Stat. 144(a)(1996)(reprinted at 47 U.S.C. §152 historical and statutory notes). However, this Act explicitly preserves a state's ability to tax satellite companies. Id. at (c).

[5]"[A] franchise is the earning value ascribed to the capital of a domestic public service corporation by reason of its operation as a domestic public service corporation." Revenue Cabinet v. Comcast Cablevision of the South, 147 S.W.3d 743, 752 (Ky. App. 2004); see also, Commercial Carriers,

The revenue generated from the Telecommunications Tax is deposited into a gross revenues and excise tax fund ("the Fund"). See Ky. Rev. Stat. §136.648(3). The Fund is held and administered by the Finance and Administration Cabinet. See Ky. Rev. Stat. §136.648(1). All revenue collected from the tax is to be deposited into the Fund to "be allocated among the State, political subdivisions, school districts, and special districts[.]" Ky. Rev. Stat. §136.648(3). The Department is charged with the task of making the monthly distributions to the various local jurisdictions, approximately thirteen hundred different jurisdictions, including to political subdivisions such as the Appellees. Ky. Rev. Stat. §136.652(2). Kentucky. Revised. Statute §136.650(1) provides that "[e]very political subdivision, school district, and special district shall participate" in the Fund. A copy of Ky. Rev. Stat. §136.650 may be found at Appendix D.

The point of the distributions from the Fund is to refund the local jurisdictions for the loss of revenue they historically received from franchise fees and the ad valorem tax imposed on the telecommunications companies' intangible franchise. The monthly distribution to a local jurisdiction is designated as "the monthly hold-harmless amount," (Ky. Rev. Stat. §136.650(2)(c)), presumably designed to eliminate harm due to lost revenue that would have otherwise resulted under the new law, prohibiting the local jurisdictions from levying franchise fees. Ky. Rev. Stat. §136.660(1).

Inc. v. Kentucky Tax Commission, 321 S.W.2d 42, 43 (Ky. 1959)("The assessment of a tax on the 'franchise' of [the taxpayer] is an attempt to reach the added value of assets of [the taxpayer] in Kentucky derived from the fact that [the taxpayer] is an operating or going concern.").

Kentucky Revised Statute §136.660(1), the provision Appellees contend must be invalidated or struck down[6] (see Appellant's Br[7]. 25, fn 10), prohibits a political subdivision from

> (a) [l]evying any franchise fee or tax on multichannel video programming service or communications service, or collecting any franchise fee or tax from providers or purchasers of multichannel video programming service or communications service;
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> (b) [r]equiring any provider to enter into or extend the term of any provision of a franchise or other agreement that requires the payment of a franchise fee or tax; or
>
> (c) [e]nforcing any provision of any ordinance or agreement to the extent that the provision obligates a provider to pay to the political subdivision a franchise fee or tax.

A copy of Ky. Rev. Stat. §136.660(1) may be found at Appendix E.

For this purpose, "franchise fee or tax" means "[a]ny tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision through a provider, in its capacity as a provider," regardless of how the tax, charge, or fee is designated, measured, set forth on the a purchaser's bill, or whether it is intended as compensation for the use of public rights-of-way. Ky. Rev. Stat. §136.660(2). The prohibition from levying or collecting franchise fees is not applicable to: (1) ad valorem taxes; (2) emergency telephone surcharges; (3) surety bonds; (4) in-kind payments of property or services; (5) letters of credit designed to protect against damages of public rights-of-way; (6) certain permit or

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[6]The Appellees also contend Ky. Rev. Stat. §136.650(1)(b)(2) requiring a political subdivision to "[a]gree[] to relinquish its right to enforce the portion of any contract or agreement that requires the payment of a franchise fee or tax[]" must be invalidated. (Appellants' Br. 25, fn 10) This reference is to the Appellees' Brief before the Court of Appeals.

[7] This reference is to the Appellees' Brief before the Court of Appeals.

inspection fees; (7) pole attachment fees; (8) fees for the placement of antennas and towers and other similar devices on public property; (9) fees or charges for the use of property or facilities owned by the political subdivision, (10) any requirement that the provider designate channel capacity for educational or other governmental use; and (11) the gross revenues license tax imposed under Ky. Rev. Stat. §§160.613 and 160.614 for schools. See Ky. Rev. Stat. §136.660(3).

"[I]f a political subdivision imposes or otherwise attempts to require the payment of a franchise fee or tax, the political subdivision shall not receive any share of the proceeds of the [Telecommunications Tax] for the period that the imposition or attempt occurs." Ky. Rev. Stat. §136.660(4). To the extent a provider actually pays a franchise fee or tax, the provider is entitled to a credit against the amount payable under the Telecommunications Tax equal to the franchise fee or tax paid to a city, up to the total tax due. See Ky. Rev. Stat. §136.660(5). Noteworthy is that subsection (7) clarifies that these provisions do not prohibit political subdivisions from requiring providers of services from "obtain[ing] a franchise as required by Section 163 of the Constitution of Kentucky and from regulating to the fullest extent authorized by state and federal law the use of local rights-of-way by communications service providers or cable service providers."

Monthly distributions from the Fund include: one percent to the Department for administrative costs; a total of $3,034,000 to the political subdivisions, school districts, and special districts for their "monthly hold-

harmless amount"; a fixed amount to sheriffs equal to their monthly "hold-harmless amount"; and $1,250,000 to the General Fund. KRS 136.652.[8]

A political subdivision's distribution amount is based upon a formula to reflect the amount of its historical collections. On or before December 1, 2005, political subdivisions certified to the Department on a prescribed form the amount of collections historically received from local franchise fees and taxes collected between July 1, 2004, and June 30, 2005. See Ky. Rev. Stat. §136.650(1)(b). The amount of collections historically received from the ad valorem tax imposed by Ky. Rev. Stat. §136.120 on the telecommunications companies' intangible franchise was calculated by the Department from assessment data for calendar year 2004. Ky. Rev. Stat. §136.650(1)(c). The Department determined each political subdivision's or other local district's monthly portion to be distributed from the Fund using the total certified collection amount (i.e. the total local franchise fees and the ad valorem tax on the franchises) to calculate a percentage, referred to in the law as "the local historical percentage". Ky. Rev. Stat. §136.650(2)(a). Each local jurisdiction receives a "piece of the pie," which is calculated by multiplying its local historical percentage by the total amount authorized to be distributed from the Fund monthly. Ky. Rev. Stat. §136.650(2)(d).

The General Assembly placed a cap of $3,034,000 on the total monthly hold-harmless amount to be distributed to the local jurisdictions, "represent[ing]

[8]The amount to be distributed to the General Fund was adjusted on a prospective basis after the collection for twelve months to equal the average monthly tax receipts attributable to the taxation of satellite broadcast and wireless cable services. Ky. Rev. Stat. §136.652(3). The adjusted amount now deposited into the General Fund is $1,523,322.75. (R. 291, fn.5)

one-twelfth (1/12) of the total potential collections[,]" or $36,408,000 annually. Ky. Rev. Stat. §136.650(2)(c). However, the total certified collections of all participants in the fund actually was $42,100,000, exceeding the General Assembly's projections of $36,408,000. (R. 291-292) Thus, monthly distributions made by the Department to every local jurisdiction fall short of the certified collection amount reported. Each political subdivision, school district, and special district receives only approximately eighty-three percent (83%) of the amount it had historically collected from franchise fees and the ad valorem tax on the franchise portion of telecommunications companies' operating property.[9]

Revenue remaining after distributions from the Fund is transferred into a second fund called the "state baseline and local growth fund". Ky. Rev. Stat. §§136.652(4); 136.648(2). Revenue transferred into the state baseline and local growth fund is bifurcated into a "local growth portion" and a "state baseline portion," and is also to be allocated and distributed monthly among local jurisdictions in accordance with the formula set forth in Ky. Rev. Stat. §136.654(3). However, revenue generated from the Telecommunications Tax has fallen short of original projections and no distributions have been made from this fund due to insufficient funds.[10]

In their petition, the Appellees asserted that the Telecommunications Tax unconstitutionally impairs their rights to levy and collect franchise fees. (R. 13,

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[9] There is no cap on the distribution amounts from the Fund to the sheriffs. Ky.Rev.Stat.§136.650(2)(b);136.652(2). Initially, each local jurisdiction received approximately 85% of its historical collections. However, the final judgment in Department of Revenue v. Lexington-Fayette Urban County Government, 349 S.W.3d 926 (Ky. App. 2010), required a re-calculation of the distribution amounts.

[10] Distributions from the state baseline and local growth fund are not authorized until collections equal an amount to allow for the state to receive a total of 84.4% and the local jurisdictions 15.6% of the revenue generated from the tax each month. Ky. Rev. Stat. §§136.654; 136.656.

¶46) Below they argued that "[a]lthough neither §163 nor §164 [of the Kentucky Constitution] explicitly state that cities cannot be prohibited from collecting franchise fees, that is a clear implication of the mandate of those provisions." (R. 219)

The Department maintained that there is no language in either section of the Constitution that takes away from the General Assembly its inherent right and power to control the levy and collection of franchise fees. (R. 295) The framers of the Constitution meant to vest the Appellees only with the ability to control the original occupation of their public rights-of-way, and to establish the rules by which a franchise must be sold "to prevent the [Appellees] themselves from giving away or granting franchises for inadequate prices, and to protect citizens against exorbitant prices by requiring competitive bidding in order to discourage monopolies." (R. 295-296) Intervening defendant, (and also an Appellant here), Kentucky CATV Association, Inc. and the lower court agreed.

> Kentucky Constitution Sections 163 and 164 do not prohibit the General Assembly from exercising control over the levy and collection of franchise fees. It is a fundamental principle that, "the power to grant franchises as an original proposition inheres in the sovereignty of the state."

(Franklin Cir. Ct. Op. 7)(quoting Kentucky Utilities Co. v. Bd. of Com'rs of City of Paris, 71 S.W.2d 1024, 1026 (Ky. 1934). " 'No language is discerned in either Section . . . indicating that the state has been deprived of the right to exercise police power and the right to implement control[.]' " Id. at 8 (quoting City of Florence v. Owen Electric Co-op, Inc., 832 S.W.2d 876 (Ky. 1992).

The Court of Appeals disagreed, opining that

> While the Commonwealth has retained considerable power to regulate local utility franchise, Section 163 of the Kentucky Constitution delegated to local government the right to grant utility franchises and necessarily the concomitant right to collect franchise fees. *See Cumberland Tel. & Tel. Co. v. City of Calhoun*, 151 Ky. 241, 151 S.W. 659 (1912). The Commonwealth may not by legislative fiat abrogate [the Respondents'] constitutionally delegated prerogative to grant a franchise and collect franchise fees. The Telecommunications Tax has effectively frustrated the ability of the local governments to collect franchise taxes, which this Court believes can only be accomplished through constitutional amendment. . . .
>
> Accordingly, we hold that the Telecommunications Tax violates Kentucky Constitution Sections 163 and 164 by prohibiting [appellees] from assessing and collecting franchise fees. We, thus, believe the circuit court improperly granted summary judgment to [the Department and Ky. CATV Association]. Rather, we are of the opinion that [appellees] are entitled to summary judgment as the Telecommunications Tax is unconstitutionally void.

(Op. 7-8)[11] Both the Department and Ky. CATV Association sought a modification or clarification of the Court of Appeals' opinion pursuant to CR 76.32, as we believe it is conceivable for the Opinion to be interpreted as declaring unconstitutional the Telecommunications Tax in its entirety. These petitions were denied. (Appendix A).

This Court granted review on February 10, 2016.

ARGUMENT

The sole question of law presented is whether the Telecommunications Tax violates Sections 163 and 164 of the Kentucky Constitution. (Motion for Discretionary Review 8; Op. 5; Franklin Cir. Ct. Op. 8)

I. STANDARD OF REVIEW

The issue of whether an act of the General Assembly is unconstitutional is a question of law subject to *de novo* review. See e.g., Freeman v. St. Andrew

[11] "Op." refers to the Court of Appeals opinion (as modified March 13, 2015).

Orthodox Church, Inc., 294 S.W.3d 425, 428 (Ky. 2009); Moore v. Ward, 377 S.W.2d 881, 883 (Ky. 1964). "The question is not what influenced the legislation, but whether the emergent law is reasonably within the scope of a legitimate public purpose." Moore v. Ward, 377 S.W.2d at 883.

II. INTRODUCTION

It is a fundamental principle that "[t]he power to grant franchises as an original proposition inheres in the sovereignty of the state[,]" (Kentucky Utilities Co. v. Bd. of Com'rs of City of Paris, 254 Ky. 527, 71 S.W.2d 1024, 1026 (1934)), although "it is competent for such sovereignty to delegate . . . such power in such agencies of government as it sees proper." Id. at 1027. In enacting Ky. Const. §§163 and 164 "it is clear that framers of the Constitution meant to vest a municipality with only the right and power to control the original occupation of its public ways and streets[,]" (City of Florence v. Owen Electric Cooperative Inc., 832 S.W.2d 876, 879 (Ky. 1992)(citing City of Paris, 71 S.W.2d at 1027)), but "[i]t is a misconception to characterize Sections 163 and 164 as eliminating total legislative authority regarding franchising." Id. "A franchise is not purely local in character." Id. For example, the creation of the Public Service Commission in an enactment by the General Assembly to provide for regulation and control of public utilities does not run afoul of the delegation by Ky. Const. §163 to political subdivisions to control the occupation of their public rights-of-way. See Southern Bell Telephone & Telegraph Co. v. City of Louisville, 265 Ky. 286, 96 S.W.2d 695 (1936); see also City of Louisville v. Louisville Home Telephone Co., 279 F. 949, 954 (6th Cir. 1922)(upholding the predecessor to Ky. Rev. Stat. §96.010 requiring

a city to offer a franchise "which shall be fair and reasonable to the public, to the corporation, and to the patrons of the corporation," as valid under §163).

Keeping these principles in mind, it is apparent that the Court of Appeals' reliance on Cumberland Telephone & Telegraph Co. v. City of Calhoun, 151 Ky. 241, 151 S.W. 659 (1912), is mistaken. That court misconceived Cumberland Telephone & Telegraph Co. as defining the scope of Ky. Const. §§163 and 164 to include delegating to the Appellees, "the concomitant right to *collect* franchise fees." (Op. at 8)(emphasis supplied) The decision in that case merely recognizes that remuneration is envisioned for a franchise granted, without considering whether §§163 and 164 mandate the levy and collection of the compensation by the political subdivisions, as we explain in more detail in Part III B(3) below.

When enacting the Telecommunications Tax, the General Assembly did not "seek to impose state taxes at the *expense* of franchise fees" (Op. at 7 (emphasis supplied), but instead, to compensate political subdivisions for the franchises granted using revenue received under the Telecommunications Tax regime that is collected and distributed by the Department. Moreover, the Appellees are not prevented from granting franchises in accordance with Ky. Const. §164 establishing how a franchise must be sold, i.e. "after due advertisement, receiv[ing] bids therefor publicly, and award[ing] same to the highest and best bidder . . ." Rather, they are free to negotiate numerous fees routinely subject to discussion when determining to whom to award a franchise, as explained in more detail in Part III B(2) below.

The elephant in the room, and the Appellees' real concern, of course, is

that the cap placed by the General Assembly upon the total monthly distributions results in their receiving only approximately 83% of their historical collections from franchise fees and the ad valorem related to the providers' franchise. (See Statement 10) Below we explain this presents only a political question; the limitation on the distribution amount in no way violates §164 because cities are not constrained to choose the highest bid when choosing to whom to grant a franchise. Further, if dissatisfied with the compensation, a city may simply opt out from participation in the Fund, as contemplated under the Act, and telecommunications providers receive a credit against their Telecommunications tax liability for fees paid to a political subdivision.

The Department's position is that the right to set the fees is neither expressly nor impliedly granted by Ky. Const. §§163 and 164, and therefore, the right remains with the State and is subject to the State's control, if exercised. The General Assembly, by enacting the Telecommunications Tax, has exercised its power not in the face of the Kentucky Constitution, but in harmony with the reserved power of the State to safeguard the vital interests of the people.

III. KENTUCKY CONSTITUTION SECTIONS 163 AND 164 DO NOT PREVENT THE GENERAL ASSEMBLY FROM EXERCISING CONTROL OVER THE LEVY AND COLLECTION OF FRANCHISE FEES.

It is a fundamental principle of State constitutional law that:

> In this State "all power is inherent in the people" (section 4, Constitution), and they, through their representatives in the Legislature, have all power except as is prescribed and prohibited by that instrument. . . . The people, then, of this commonwealth, being jealous of their power, are not inclined to restrict or limit the power of their representatives in the Legislature, unless forced to do so by the plain and unambiguous language employed by the Constitution[.]

Bd. of Education of Louisville v. Sea, 167 Ky. 772, 181 S.W. 670, 673 (1916); see also, Batesville Casket Co. v. Fields, 288 Ky. 104, 155 S.W.2d 743, 745 (1941)("The Legislature may pass any act not forbidden expressly or by necessary implication by the Constitution."). "It is different with the federal Constitution, in that Congress under that instrument has no power except that which is given to it by the federal Constitution. Bd. of Education of Louisville v. Sea,181 S.W. at 673; see also, Burton v. Mayer, 274 Ky. 245, 118 S.W.2d 161, 164 (1938)("Our state Constitution is not a grant of power to the Legislature as is the federal Constitution, but is a limitation upon its powers, and it possesses every power not denied it by the Constitution of the state or of the United States."). Thus,

> whensoever the language of [the Ky. Const.] may be susceptible to a construction upholding an act of the Legislature, or to a construction which would render it invalid, it is the duty of the courts to adopt the former and to hold the act constitutional, rather than unconstitutional.

Bd. of Education of Louisville v. Sea,181 S.W. at 673; see also, Bd. of Trustees of House of Reform v. City of Lexington, 112 Ky. 171, 65 S.W. 350, 353 (1901)("[W]hatever doubts may be existing concerning the constitutionality of the act in question must, under familiar and wise rules of construction, be resolved in favor of its constitutionality."); Bowman v. Frost, 289 Ky. 826, 158 S.W.2d 945, (1942)("[W]hen the power of the Legislature to enact a law is called in question, the court should proceed with the greatest possible caution and should never declare an act invalid until after every doubt has been resolved in its favor."). Indeed,

> Kentucky cities [] possess only such powers as are expressly granted by the constitution and statutes of Kentucky, plus such powers as are necessarily implied or incident to the expressly granted powers, and which are indispensable to enable the municipality to carry out its declared objects, purposes and expressed powers. (citation omitted) Moreover, any reasonable doubt as to the existence of the city's power is to be resolved against the municipality.

Griffin v. City of Paducah, 382 S.W.2d 402, 404 (Ky. 1964). The provisions of the Kentucky Constitution at issue must be interpreted according to their plain meaning. See Jefferson Co. ex rel. Grauman v. Jefferson Co. Fiscal Court, 273 Ky. 674, 117 S.W.2d 918, 924 (1938)("Neither legislatures nor courts have the right to add to or take from the simple words and meaning of the constitution."). The circuit court's opinion was informed by these principles of constitutional interpretation, (see Cir. Ct. Op. 10); the reasoning of the Court of Appeals in its Opinion, however, is not.

> Again, Kentucky Section 163 provides:
>
> No street, railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or erect poles, posts or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply.

Section 164 provides:

> No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such a franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any and all bids. This section shall not apply to a trunk railway.

As can be plainly seen, there is no language in either constitutional section that takes away from the General Assembly its inherent power to control the levy and collection of franchise fees. Further, despite the Court of Appeals Opinion otherwise, nor is such a mandate implied, as we explain below.

A. The Framers of the Kentucky Constitution intended only to vest political subdivisions with the right to control the original occupation of their rights-of-way.

The Opinion overlooks that "it is clear that framers of the Constitution meant to vest a municipality with only the right and power to control the original occupation of its public ways and streets[.]" City of Florence, 832 S.W.2d at 879 (citing City of Paris, 71 S.W.2d at 1027).

> [O]ur problem in the instant case is to determine how far the people by their Constitution have stripped from their Legislature such power and given it to local bodies, here, the municipalities. . . . A reading of the debates of the Constitutional Convention bearing upon this section of the Constitution will disclose that the main and actuating purpose of the framers of that instrument was to prevent the Legislature from authorizing the indiscriminate use of the streets of the city by public utilities without the city being able to control the decision as to what streets and what public ways were to be occupied by such utilities.

City of Paris, 71 S.W.2d at 1027 (upholding statute requiring the city to give the original franchise holder an opportunity to get a new one upon expiration because the framers "put no obstacle in the way of the Legislature" id. at 1028).

Similarly, the Opinion ignores that "in effect [Section 164] does not expand the authority conferred by Section 163." City of Florence, 832 S.W.2d at 881 (citing Ray v. City of Owensboro, 415 S.W.2d 77, 79 (Ky. 1967)). Rather, the purpose of §164 is to set forth the manner in which the consent to occupy streets and public ways must be granted so as to prevent the political subdivisions from

giving away or granting franchises for inadequate prices, and to protect citizens against exorbitant prices by requiring competitive bidding in order to discourage monopolies.

> The evident purpose of [Section 164] of the Constitution was to prevent councils of cities from giving away or selling at an inadequate price the rights and privileges belonging to the citizens, and compel the disposition of such valuable rights to be made publicly, to the end that the citizen might obtain the greatest price possible. The Constitution of the state imposes upon legislative bodies the duty to protect the citizens against monopolies, trusts, and unlawful combinations. No more important obligations are imposed upon a legislative body than that of shielding the citizen against extortion in matters of public necessities; no higher duty than that of opening the doors to the fullest competition in such matters.

Stites v. Norton, 125 Ky. 672, 101 S.W. 1189, 1190 (1907); Hilliard v. George G. Fetter Lighting & Heating Co., 127 Ky. 95, 105 S.W. 115, 118 (1907)("To remedy the notorious and often scandalous wrongs perpetrated by municipal boards and authorities, [Section 164] was enacted, and the rights of the public attempted to be safeguarded and protected by providing that no franchise or privilege intended to be permanent should be granted, except to the highest and best bidder after due advertisement and public award.").

While the Court of Appeals appears to recognize that "Section 164 has been interpreted as a limit upon that delegated authority[,]" (Op. 7), it erroneously concludes that the constitutional mandate requiring a competitive bidding process amounts to a delegation to political subdivisions to completely control the process, despite the intent was to "remedy the notorious and often scandalous wrongs" perpetrated by the Appellees, themselves. Thus, the lower court's determination that "Section 163 of the Kentucky Constitution delegated to

local government the right to grant utility franchises and necessarily the concomitant right to collect franchise fees[,]" (Op. 8), is neither supported by the express language, nor any authority declaring the intention of the framers of the Constitution. Below however, we explain in more detail why the provisions of the Telecommunications Tax requiring the Appellees to refrain from levying or collecting franchise fees and taxes in order to partake from the Fund, does not run afoul of the requirements of Ky. Const. §164.

B. The Telecommunications Tax does not prevent political subdivisions from complying with the "highest and best bidder" requirement of Kentucky Constitution Section 164.

The fact that they must refrain from collecting franchise fees does not impair a political subdivision's ability to receive remuneration or to award a franchise to the highest and best bidder.

1. The Appellees continue to receive remuneration for the franchise.

In the first place, as noted by the Franklin Circuit Court, the Appellees continue to receive remuneration for the franchise. Compensation for the use of the Appellees' rights-of-way is the revenue they receive under the Telecommunications Tax regime collected and distributed to them by the Department. (See Franklin Cir. Ct. Op 10 ("Under the Telecommunications Tax, [the Appellees] are still compensated for the use of rights-of-way, via the monthly 'hold harmless' distribution.")). Moreover, consideration other than franchise fees is provided in exchange for the grant of a franchise. Recall, Ky. Rev. Stat. §136.660(3) expressly provides that prohibition from levying or collecting of franchise fees is not applicable to numerous fees which are items routinely

subject to negotiation in franchise agreements such as: emergency telephone surcharges; surety bonds; in-kind payments of property or services; letters of credit designed to protect against damages of public rights-of-way; certain permit or inspection fees; pole attachment fees; fees for the placement of antennas and towers and other similar devices on public property; fees or charges for the use of property or facilities owned by the political subdivision, and any requirement that the provider designate channel capacity for educational or other governmental use. Thus, although we agree with the Court of Appeals' Opinion in that remuneration to the Appellees is envisioned in exchange for the grant of a franchise, (see Statement at 2, (citing City of Owensboro v. Top Vision Cable Co. of Ky.); our point is that the Appellees continue to be compensated for the use of their rights-of-way.

2. The Appellees can award franchises to the highest and best bidder.

Furthermore, the Appellees can continue to award their franchises to the highest and best bidder under the Telecommunication Taxing framework. "[T]he primary purpose of granting the franchise is not to obtain revenue, but to give the city reasonable control over the service and terms of service." Town of Hodgenville v. Gainesboro Telephone Co., 237 Ky. 419, 35 S.W.2d 888, 889-890 (1931).

> What [] is commonly termed the "granting" of a franchise by a city for one of these public utilities is in the nature of a contract by the city with the grantee for the performance of a public service. . . . From this view of the subject it will readily be seen that the primary object a city would have, in contracting for or procuring the service of such utilities, is not the revenue to be obtained for the city, but the securing of good and efficient service, and upon such terms as

> will, in the judgment of the city's governing body, promote the greatest good[.]

Louisville Home Telephone Co. v. City of Louisville, 130 Ky. 611, 113 S.W.855, 861 (1908). In other words, when determining the "highest and best bidder," the franchise fees offered in bid proposals are not of chief importance. Other important elements to be considered are technical proposals, mix of services offered, the ability to build and operate the system as promised (i.e. experience and financial situation), and to a lesser extent, rates. See e.g., Communications Systems, Inc. v. City of Danville, Kentucky, 880 F.2d 887, 889 fn.2 (6th Cir. 1989)(city official describing important elements to be considered when city evaluates proposals to determine the "highest and best bidder").

Further, a municipality's rejection of what appears to be the highest bid and acceptance of a lower bid as the best bid satisfies the dictates of Ky. Const. §164 "if the decision is based on the exercise of sound discretion, untainted by arbitrariness or corruption." Communications Systems, Inc., 880 F.2d at 889 (citing Baskett v. Davis, 311 Ky. 13, 223 S.W.2d 168 (Ky. 1949)). Therefore, the competitive bid process is not destroyed merely because under the framework of the Telecommunications Tax an element of the remuneration received for the franchise is the same (i.e. the monthly distribution resulting from the Telecommunications Tax). The Appellees are not constrained to choose the "highest" bid, and they routinely consider other elements when determining to whom to award a franchise.

3. The Appellees will continue to receive adequate compensation.

Finally, to the extent the Court of Appeals' determination that Ky. Const. §§163 and 164 "delegated prerogative to [the Appellees] to grant a franchise and collect franchise fees[]" (Op. 8), because the Appellees are "effectively frustrated" (Op. 8), presumably due to the *amount* they receive as a participant in the Fund, hinges on that Court's mistaken belief that a franchise is purely local, and it has misconceived Cumberland Telephone & Telegraph Co. as defining the scope of these provisions as inclusive of all rights relating to the granting of a franchise. As explained above, since the right to set the fees is not expressly granted in Sections 163 and 164, the right remains with the State and is therefore subject to the State's control, if exercised. Just as statutes enacted by the General Assembly to effectuate Ky. Const. §§163 and 164 and to confer the control of rates and service upon the Public Service Commission have been upheld as valid, so must the statutory framework for the Telecommunications Tax. See e.g., City of Louisville v. Louisville Home Telephone Co., 279 F. 949, 954 (6th Cir. 1922)(upholding the predecessor to KRS 96.010 as valid under §163); Southern Bell Telephone & Telegraph Co. v. City of Louisville, 265 Ky. 286, 96 S.W.2d 695 (1936)(upholding as constitutional the creation of the Public Service Commission by an enactment of the General Assembly to provide for regulation and control of public utilities).

The Court of Appeals reliance on Cumberland Telephone & Telegraph Co. as relaying a rule that political subdivisions have absolute control over the levy and collection of franchise fees is erroneous and flies in the face of the holdings

in later cases recognizing "[i]t is a misconception to characterize Sections 163 and 164 as eliminating total legislative authority regarding franchising." (Part I, Introduction, p. 13, citing City of Florence v. Owen Electric Cooperative Inc., 832 S.W.2d at 879). Instead, we read Cumberland Telephone & Telegraph Co. as relevant here for its holding that " 'the right to occupy the streets and public ways conferred by Section 163 can only be granted in the manner provided in Section 164.'" Cumberland Telephone & Telegraph Co., 151 S.W. at 661-662 (quoting Rural Home Telephone Co. v. Ky. & Ind. Telephone Co., 128 Ky. 209, 107 S.W. 787, 790 (1908)). The facts there indicated the telephone company had not been granted a "constitutional franchise;" rather, the City of Calhoun had granted permission via a resolution and not followed the advertising and bidding requirements of Section 164. Id. at 659-660. As such, the Court upheld the license tax imposed by the city because the company had to date only paid an ad valorem tax, which included an amount based on the value of its franchise. Although a city "cannot exact, for the privilege of doing business, both a franchise tax and a license tax at the same time or for the same period[,]" (id. at 660), the telephone company did not in fact, have "a franchise authorizing it to operate and conduct a telephone exchange in the City of Calhoun, and to occupy the streets[.]" Id. In this context, the court spoke of the "constitutional franchise" envisioned by Ky. Const. §§163 and 164 as a right

> sold by the city . . . not only to occupy its streets, the consideration being compensation for the rights of way, but [also] it was for operating its exchange in the city and receiving tolls thereat upon its business.

Id. Thus, Cumberland Telephone & Telegraph Co. illustrates that remuneration is contemplated by Ky. Const. §163 and 164, but in no way interprets these constitutional provisions as conferring to political subdivisions total control over franchise fees.

When considering whether a franchise granted is valid, including considering the remuneration provided:

> where there is no legislative prohibition of a certain character of agreement . . . it must appear that such an agreement or contract has a tendency to injure the public or is against the public good, or is contrary to sound policy and good morals.

City of Princeton v. Princeton Electric Power & Light 166 Ky. 730, 179 S.W. 1074, 1078 (1915)(finding invalid a franchise granted by the city which was not advertised or offered for sale publicly and the time of its exercise was to commence four and one-half years after the granting of it). The policy behind the requirements of §164 to award a franchise to the "highest and best bidder" is to "regulate the granting of franchises so that the benefits of their exercise may be shared by the public, and to prevent them from being granted primarily for the benefit of the grantees." Id.; see also, Town of Hodgenville v. Gainesboro Telephone Co., 237 Ky. 419, 35 S.W.2d 888, 889-890 ((1931)(finding sufficient consideration for the granting of a franchise based upon the fact that franchises in cities of the sixth class "rarely bring more than the cost of advertising" and noting, "the primary purpose of granting the franchise is not to obtain revenue, but to give the city reasonable control over the service and terms of service.") As we discussed above, the Telecommunications Tax does just that; Ky. Rev. Stat. 136.660(3) makes clear that political subdivisions are free to negotiate and

exercise control over the terms of service that are of chief importance. Furthermore, the Appellees have presented no evidence to indicate that amounts received from the Fund as remuneration is injurious to the public or contrary to sound public policy. While the Appellees may be in receipt of only 83% of their historical collections, the General Assembly's goals to provide a fair, efficient and uniform method for taxing telecommunication services and to overcome the limitations placed upon the taxation of these services by the federal law, among others as set forth in Ky. Rev. Stat. §136.600, are being fulfilled by the Telecommunications Tax regime.[12]

At any rate, the "savings clause" found in Ky. Rev. Stat. §136.660(4) and (5) contemplates that a political subdivision may choose to require payment of franchise fees by forfeiting its share of the proceeds of the Telecommunications Tax. Thus, the Appellees may opt out of the tax altogether if they perceive their distribution amounts are inadequate.

C. Whether the award of a franchise "is governed exclusively by Section 181 of the Kentucky Constitution" as the circuit court opined is of no importance to the question presented.

Here we state that the lower court may be mistaken in its conclusion that "the award of a franchise [ ] is governed exclusively by Section 181" of the Ky. Const. (Franklin Cir. Ct. Op. at 9), but we determined that this issue is not dispositive to the question presented by the Appellees; therefore, rather than

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[12] Recall, pursuant to §602 of the federal Telecommunications Act of 1996, the satellite companies are exempt from all local taxes and fees. See Stmnt. of the Case at 5 (citingPub. L. No. 104-104, Title VI, §602(a), 110 Stat. 144(a)(1996)(reprinted at 47 U.S.C. §152 historical and statutory notes)). However, this Act explicitly preserves a states' ability to tax satellite companies. Id. at (c).

appeal, we left the issue for another day. Briefly, we believe that the franchise fee here at issue is not the occupational or license tax referred to in Ky. Const. §181, but instead compensation for the use of the public right-of-way. In any event, the prohibition of Ky. Rev. Stat. §136.660(1) encompasses both the franchise fees governed by Ky. Const. §163 and 164, and the license and occupational taxes governed by Ky. Const. §181. See Ky.Rev. Stat. §§136.660(2); 92.281(8). We ask this Court to affirm the Circuit Court's judgment, and note that "it is well settled that [this Court] [is] not bound by the analysis of [a lower court] and may affirm on any grounds supported by the record." Southern Financial Life Insurance Co. v. Combs, 413 S.W.3d 921, 926 (Ky. 2013).

Accordingly, Kentucky Constitution Sections 163 and 164 do not preclude the General Assembly from prohibiting the Appellees from levying and collecting franchise fees. Further, the Telecommunications Tax does not purport to give utilities the right to use Appellees' rights of way without their consent, the right that is guaranteed by §§ 163 and 164. The tax therefore does not offend the limitations or prohibitions of these constitutional provisions. See e.g., TCG Detroit v. City of Dearborn, 680 N.W.2d 24, 39-41 (Mich. App. 2004)(Michigan's telecommunications act limiting fees charged by a city to a telecommunications company for use of rights-of-way did not run afoul of Michigan's constitutional provisions requiring public utilities to obtain the consent of the city to use public rights-of-way and reserving to a city the right to the "reasonable control of its streets").

IV. THE TELECOMMUNICATIONS TAX DOES NOT VIOLATE THE "CONTRACT CLAUSE" OF EITHER THE UNITED STATES OR KENTUCKY CONSTITUTIONS.

Finally, here we briefly mention that the legislation is not invalid merely because of its incidental effect on existing franchise agreements. Milner v. Gibson, 249 Ky. 594, 61 S.W.2d 273, 278 (1933). The protection of the "contract clause" found in Article 1, Section 10, of the United States Constitution, and in Section 19 of the Ky. Constitution, extends to contracts between a State (or subdivisions thereof) and a private person. City of Covington v. Sanitation Dist. No. 1 of Campbell & Kenton Cos., 301 S.W.2d 885, 888 (Ky. 1957). However, public service corporations are proper subjects of legislative control, and therefore, the State may lawfully impose regulations in the exercise of its police power to protect the welfare of the public. Milner v. Gibson, 61 S.W.2d at 278.

> It may be treated as an implied condition of every contract and, as such, as much part of the contract as though it were written into it whereby the State's exercise of its power enforces, and does not impair, a contract. A more candid statement is to recognize . . . that the power "which, in its various ramifications, is known as the police power, is an exercise of the sovereign right of the government to protect the * * * general welfare of the people, and is paramount to any rights under contracts[.]"

East New York Sav. Bank v. Hahn, 326 U.S. 230, 233 (1945)(quoting Manigualt v. Springs, 199 U.S. 473, 480 (1905). Among the purposes for the legislation, as expressly provided in Ky. Rev. Stat. §136.600, are to provide for "a fair, efficient, and uniform method" for taxing all telecommunication providers (Ky. Rev. Stat. §136.600(1)) , to "simplify the current morass of local taxes and franchise fees that cable companies face" (DirecTV, Inc. v. Treesh, 487 F.3d 471, 480 (6th Cir. 2007); see also, Ky. Rev. Stat. §136.600(3)) and "to provide enough flexibility to

address future changes brought about by industry deregulation, convergence of service offerings, and continued technological advances" (Ky. Rev. Stat. §136.600(4)). Thus, prohibiting the Appellees from levying and collecting franchise fees is a reasonable exercise of the State's inherent power to safeguard the vital interests of its citizens.

CONCLUSION

Based on the foregoing, Kentucky Constitution Sections 163 and 164 do not prevent the General Assembly from exercising control over the levy and collection of franchise fees. In enacting these Constitutional provisions, the framers of the Constitution intended only to vest political subdivisions with the right to control the original occupation of their rights-of-way, through a process which safeguards and protects the public by requiring that no franchise or privilege be granted by a political subdivision, except to the highest and best bidder after due advertisement, to ensure good and efficient service upon such terms as will promote the greatest good.

When enacting the Telecommunications Tax, the General Assembly did not seek to impose state taxes at the expense of franchise fees, but instead, to compensate political subdivisions, including the Appellees, using revenue received under the Telecommunications Tax regime. By enacting the Telecommunications Tax, the General Assembly has exercised its power not in the face of Ky. Const. §§163 and 164, but in harmony with the reserved power of the State to safeguard the vital interests of the people.

Accordingly, the Court of Appeals erred in reversing the Franklin Circuit Court's judgment upholding the Telecommunications Tax as valid under the Kentucky Constitution. Thus, the Opinion should be reversed, and the judgment of the Franklin Circuit Court affirmed and reinstated.

Respectfully submitted,

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